

THE DIRECTOR OF CENTRAL INTELLIGENCE

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National Intelligence Council

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MEMORANDUM FOR: Dr. Norman A. Bailey
Director, Planning and Evaluation
National Security Council

FROM: Maurice C. Ernst
National Intelligence Officer for Economics

SUBJECT: US Policy on East-West Economic Relations:
A Conceptual Framework

Norman:

After the last IG meeting you told me that you and your staff were working on a conceptualization of US policy concerning East-West economic relations, and said you would welcome any suggestions on this subject. These are some personal views on how such a policy might be defined. You will recognize many ideas from your own memos. I have tried to broaden the framework a bit, and hope you will find these thoughts useful.

[Redacted Signature]

Maurice C. Ernst

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Attachment

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SUBJECT: US Policy on East-West Economic Relations: A Conceptual Framework

Objectives

1. US objectives in policy concerning trade with Soviet bloc countries are economic, political, and strategic, notably:
 - a. to obtain economic gains from trade (access to cheaper imports and markets for exports).
 - b. to minimize Soviet bloc access to products and technology with unique military uses.
 - c. to influence Soviet policies along lines less inimical to the US.
 - d. to encourage greater East European independence from Moscow.
 - e. to minimize Soviet opportunities to use economic issues to disrupt the Western alliance.

Limitations on Economic Influence

2. Our ability to influence Soviet policies is limited, indirect, subtle, and uncertain. Economic influence on Soviet policies can come only by affecting the costs of Moscow's policy options. It is unrealistic to expect that any Western economic actions could force Moscow to significantly modify its military or foreign policies. The track record of economic sanctions is not encouraging. Nor are we likely to find major areas of direct economic leverage on the USSR. These severe limitations on economic influence are due to the large size of the Soviet economy, its relatively small dependence on trade with the West, and the tendency of the Soviet government, indeed of most governments, to react negatively to foreign pressure.
3. The small direct US role in total East-West trade and the limitations on US ability to control trade indirectly (i.e., through controls over licensing, branches and subsidiaries) makes allied cooperation essential if the West is to take advantage of any potential for influence.
4. Another important limitation on the West's ability to exercise economic influence on Soviet Bloc countries results from different perceptions of relations with the East. The West Europeans consider East-West economic linkages to be an underlying influence for peace and stable relations in Europe.
5. Although Eastern Europe has developed a substantial dependence on trade with Western Europe, the ability of Western countries to use economic influence is circumscribed. The reasons include the limits imposed by Moscow

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on East European policies through force of arms and the conflicting objectives of the Western countries themselves. There are instances of tradeoffs between political and economic concessions--such as the provision of credits and subsidies from West Germany to East Germany in exchange for allowing West Germans to visit their relatives in East Germany--but these deals should more properly be viewed as instances of Eastern political leverage on the West than as Western economic leverage on the East.

The Basis for Economic Influence

6. The USSR and the Soviet Bloc will be more susceptible to Western economic influence in the 1980s than in the past because: 1) Soviet Bloc economic performance has greatly worsened; 2) some of their economic problems could be ameliorated through imports from the West; and 3) market conditions are generally unfavorable to Soviet Bloc foreign exchange earnings, making these countries more dependent than usual on help from Western governments.

7. Market conditions were extremely favorable to the USSR in the 1970s. The surge of oil prices directly or indirectly paid for probably three quarters of the increase in Soviet hard currency imports. For at least several years in the 1980's both real oil prices and the volume of Soviet oil exports are likely to drop. The only way the USSR can come close to maintaining its purchasing power over hard currency imports is to make deals with Western governments to develop exportable goods, especially natural gas, using guaranteed and often subsidized credits. This reliance on government-to-government deals gives the Western side a basis for some potential influence.

8. In Eastern Europe, not only are economic conditions worsening, but there is also a possibility of political unrest that would open up opportunities for Western economic actions to influence the outcome.

Possible Policy Criteria

9. Even so, only extremely modest expectations are warranted as to ability of the US to influence Soviet and East European policies with economic tools.

- o At a minimum, we can try to avoid damage to our interests.
- o We can also hope to influence, at least marginally, the pressure for change within the Soviet system.
- o But we cannot have much hope of trading off economic for political concessions.

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10. The following policy criteria appear consistent with this analysis.
- a. Ordinary commercial trade with Soviet Bloc countries is acceptable, except under extraordinary circumstances, such as Soviet actions constituting a major threat to the alliance, and in the case of strategic trade. The rationale is as follows:
 - o Both sides normally gain from trade;
 - o Neither our allies nor important US interest groups (e.g. farmers) would accept systematic restriction of ordinary trade.
 - o This trade is likely to decline for at least several years because of Soviet Bloc economic problems, excessive hard currency debt and weak world markets for Soviet exports, especially for oil.
 - b. Strategic trade should be forbidden. This refers to exports of Western products and technology which contributes in some unique way to Soviet Bloc military capabilities.
 - o Our allies support such a policy in principle.
 - o But the burden of showing specific connections between Western exports and Soviet bloc military uses will continue to fall on the US.
 - c. Western government subsidies of exports to the East should be eliminated or at least minimized--it makes no sense to subsidize an adversary. This policy does not require agreement on specific formulae for inducing government-supported credits. It is highly unlikely that any formula acceptable to all our major allies can be found.
 - o Government guarantees for export credits contain an element of subsidy. They should be used only for an agreed purpose.
 - o Subsidized interest rates should be eliminated.
 - d. Major projects involving Western governments should be discussed among the Alliance at an early stage in order to determine their impact on the Alliance's interests and to maximize the bargaining position of the Western partners.
 - o Big East-West projects, such as the Yamal pipeline, entail a variety of inducements, and government policy considerations, such as diversification of energy sources, reduction of

unemployment, and increased mutual dependence. Alliance interests, as well as national interests, are involved. Discussion of such projects before any commitments are made will not prevent differences among Alliance members, but may avoid rancor.

- o Discussion should permit the advantages and disadvantages of the project for the Alliance to be weighed -- including the impact on the Soviet Bloc and Western economies, on the supply and sources of energy, etc., on financial markets, and on the political and strategic position of both sides.
- o Finally, discussion of a project could lead to a joint Western approach resulting in a better bargaining position and more favorable terms.
- e. Western governments should differentiate in their treatment of Soviet bloc countries with respect to debt rescheduling, and major projects, but probably not interest rates.

What Could We Expect from Such a Policy

11. From our Allies:

- Great relief that the US does not intend major "economic warfare" against the USSR.
- General acceptance of the principle of no subsidization of exports, but with exceptions to protect market shares (e.g. in the case of France).
- No increase in the volume of government-guaranteed credits.
- Reluctant agreement to discuss big projects, but with no prior commitments. Each country will insist on being the final judge of the balance of advantage in each case.

12. From the USSR:

- A reduced ability to take advantage of US-West European differences.
- A reduced ability to rely on Western help to ease economic problems, and consequently to avoid hard decisions on resource allocation and economic reform.
- Possibly some added inducements to accommodate the US or other Western countries on matters which do not affect major Soviet interests.

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13. From Eastern European countries:

- A continued experimentation with economic reforms, but no major departures from Communist political control and Soviet foreign and defense policy.

14. Following these policies is likely to result in stagnant or declining East-West trade. Given the Soviet bloc's severe economic problems, there is clearly a potential for a substantial Western role to ameliorate these problems. Such a role could not even be contemplated, however, except in the event Soviet foreign and strategic policies changed dramatically for the better.

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